Hongkong Bank of Canada

Annual Report 1997

MEETING THE NEEDS OF AN EXPANDING CUSTOMER BASE

Member HSBC *Group*

CONNECTIONS

Life's changes drive customers' financial needs.

Our expertise lies in responding to our customers' needs with a wide range of financial services.

In today's world, we have more options than ever before. Consequently, it becomes increasingly difficult to make the right decisions about who we can turn to for solid financial advice. Building trust means cultivating long-term relationships. At Hongkong Bank of Canada, we connect the diverse needs of our customers to provide a seamless global network of financial services.

Contents

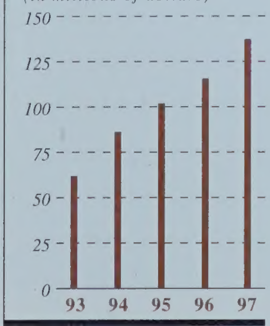
Financial Summary

Annual Highlights

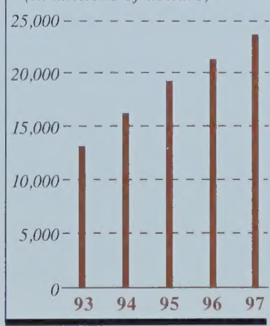
For the years ended October 31 (in millions of dollars)	1997	1996	Change	1995	1994	1993
Earnings Information						
Income before tax	**$ 221**	*$ 187*	*18.18%*	*$ 172*	*$ 136*	*$ 92*
Net income	**138**	*118*	*16.95*	*102*	*86*	*63*
Net interest and other income [(1)]	**733**	*640*	*14.53*	*548*	*477*	*395*
Provision for credit losses	**38**	*53*	*(28.30)*	*63*	*62*	*51*
Non-interest expenses	**474**	*400*	*18.50*	*313*	*279*	*252*
Financial Ratios (%)						
Return on average common equity	**20.19%**	*19.49%*	*0.70 p.c.p.*	*17.78%*	*16.69%*	*13.29%*
Return on average total assets	**0.61**	*0.59*	*0.02*	*0.60*	*0.59*	*0.51*
Non-interest expenses to income ratio	**64.67**	*62.50*	*(2.17)*	*57.12*	*58.46*	*63.87*
Net non-performing loans as a percentage of loans and acceptances [(2)]	**(0.39)**	*(0.24)*	*(0.15)*	*0.28*	*0.98*	*2.67*
Financial Position as at October 31						
Total assets	**$ 23,910**	*$ 21,209*	*12.74%*	*$ 19,580*	*$ 16,021*	*$ 13,519*
Total loans	**16,454**	*15,011*	*9.61*	*13,657*	*11,914*	*10,379*
Commercial loans	**7,940**	*7,139*	*11.22*	*6,355*	*5,921*	*5,494*
Residential mortgage loans	**6,876**	*6,453*	*6.56*	*5,841*	*4,742*	*3,702*
Total deposits	**20,115**	*18,353*	*9.60*	*17,207*	*14,244*	*11,979*
Personal deposits	**9,922**	*9,789*	*1.36*	*9,377*	*8,051*	*7,060*
Debentures	**549**	*583*	*(5.83)*	*463*	*352*	*350*
Shareholder's equity	**671**	*623*	*7.70*	*577*	*526*	*499*
Mutual funds	**1,629**	*1,179*	*38.17*	*381*	*325*	*97*
Funds under management [(3)]	**1,822**	*1,296*	*40.59*	–	–	–
Risk-Based Capital (%)						
Tier 1	**4.7%**	*5.1%*	*(0.4) p.c.p.*	*5.4%*	*5.4%*	*5.6%*
Total	**8.9** [(4)]	*9.6*	*(0.7)*	*9.4*	*8.7*	*9.1*

Notes: 1. This represents the total of net interest income and other income before deduction for credit losses 2. Net of specific and general allowance 3. Excludes the Bank's mutual funds under management 4. On November 6, 1997 the Bank issued a $60 million debenture. Proforma total risk-based capital at October 31, 1997 would be 9.3%.

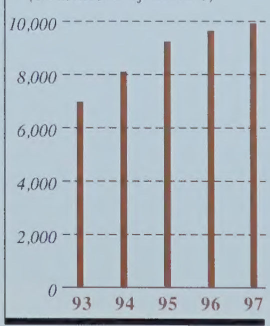
NET INCOME
(in millions of dollars)



TOTAL ASSETS
(in millions of dollars)



PERSONAL DEPOSITS
(in millions of dollars)

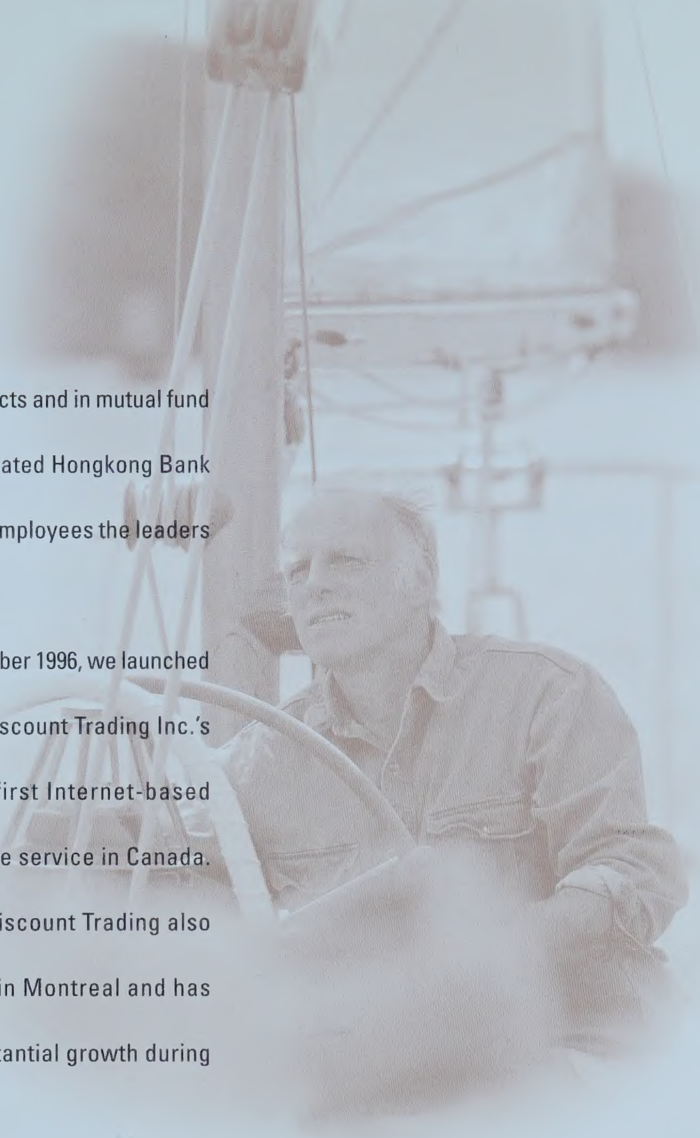


New directions – new services

Our customers need to prepare for the changes life brings. That's where the Bank can really help.

This past year was devoted to building the inter-connections between the various parts of the company. The aim was to introduce our customers to the wide range of services we can provide and encourage them to broaden their relationship with Hongkong Bank of Canada. We devoted time and effort to improving our employees' product knowledge and sales skills, enabling them to more effectively meet the financial services needs of our customers.

The results for the fiscal year were most satisfactory and achieved our goals for both profitability and growth. Our success reflects the continued growth of the Canadian economy and, in part, our reputation as an outstanding financial services provider.



The quality of our loan portfolio continues to be good and is the result of judicious and sound credit administration. In the trade finance market, our share of this business continues to exceed our share of total bank assets in Canada, and our market share in the provision of private banking facilities across the country is significantly larger than our share of bank assets.

Independent surveys of personal and commercial customer satisfaction and product knowledge, both in core banking products and in mutual fund sales, once again rated Hongkong Bank of Canada and its employees the leaders in the industry.

In November 1996, we launched Hongkong Bank Discount Trading Inc.'s *net*TRADER, the first Internet-based discount brokerage service in Canada. Hongkong Bank Discount Trading also opened an office in Montreal and has experienced substantial growth during the past year.

From left to right: J.L.Gordon, Senior Exective Vice-President; J.H. Cleave, Incoming Chairman; J.R.H. Bond, Outgoing Chairman; W.R.P. Dalton, Outgoing President and Chief Executive Officer; Y.A. Nasr, Incoming President and Chief Executive Officer; M.J.G. Glynn, Chief Operating Officer.

People adapt, change, retrain, all through their working lives. At Hongkong Bank of Canada, we see our response to change as a measure of our performance in serving our customers.

Staying competitive –

HSBC James Capel Canada Inc., our Toronto-based, full-service brokerage firm, established a new forward direction and has experienced success in all facets of its business. The HSBC James Capel Canada name is associated with a significant number of new equity and security issues and is gaining a reputation for sound and respected service.

Our merchant banking firm, HSBC Capital Canada Inc., opened offices in both Toronto and the Hong Kong Special Administrative Region of China and announced the start of a $25 million private equity fund.

In December of last year, Hongkong Bank of Canada received final approval from regulatory authorities in both the United States and Canada permitting the Bank to operate branches in Seattle and Portland in the United States.

This action, combined with the operations of our sister bank, Marine Midland Bank of Buffalo, New York, enables us to provide Canada / US banking for our customers who are taking advantage of growing north-south trade.

Our branch network, combined with Service*Plus*, our telephone banking network for both retail and corporate customers, allows us to provide banking services throughout the country. Service*Plus* continues to grow as customers find the availability of 24-hours a day, seven-days-a-week banking a great convenience. Our Telefund system, which permits trading in Hongkong Bank Mutual Funds, has proven to be very popular. Our new Commercial Bank Card, launched in 1997, provides corporate customers with the capability of making deposits and withdrawals at Automated Banking Machines. And Hexagon, our PC-based electronic banking service, grew its customer base by 35% during the year.

Three new Directors, Donald C. Lowe, Chairman of Sedgwick Limited and Robert W. Martin, Chairman of Silcorp Ltd., both of Toronto; and Gwyn Morgan, President and CEO of Alberta Energy Company Ltd., of Calgary, joined the board in fiscal 1997. William R.P. Dalton resigned as a Director at the December meeting of the Board.

As announced, I have stepped down as Chairman of the Board effective December 31, 1997 and this role will be assumed by James H. Cleave, recently retired President and Chief Executive Officer of Marine Midland Bank of Buffalo, New York, who served as President and Chief Executive Officer of Hongkong Bank of Canada from 1987 to 1992. In my new capacity, effective May 1, 1998, as Group Chairman, HSBC Holdings plc, I shall continue to follow with great interest the fortunes of Hongkong Bank of Canada.

As we look forward to 1998 our focus will be on deepening the relationship with each of our customers, enhancing our reputation for providing superior service and maximizing the benefits customers of Hongkong Bank of Canada receive through our global connections with the HSBC Group.

John R.H. Bond
Chairman of the Board

December 31, 1997
Vancouver, B.C.

Creating connections: finding the best possible solutions for our customers.

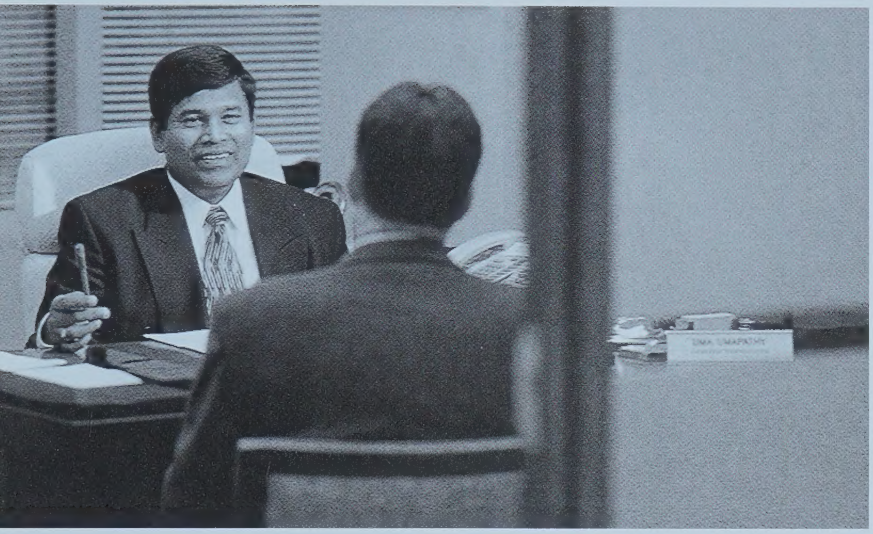
We offer a diverse range of products and services worldwide to fulfill the individual needs of our customers.

Irene Yan, CSR "I am constantly taking courses to upgrade myself so I can be more knowledgeable and of more service to my customers. I love investments – it's my hobby and my job."

Less than three years ago, Hongkong Bank of Canada's business was focused primarily on providing traditional banking services. We accepted deposits and provided credit to businesses and individuals, traded in foreign exchange, government securities and money market instruments, and provided trade finance services. While some of our customers were beginning to use alternative delivery systems such as Automated Banking Machines with instantaneous worldwide access to their accounts, the basic nature of banking was not appreciably different from what it had been for over a century.

Today, however, Hongkong Bank of Canada, while still providing high quality traditional banking services, offers a much broader range of services and products capable of meeting every conceivable financial need of our customers, now and in the future. The short vignettes accompanying pictures of our staff illustrate both the diversity of our products and services and how our customers are taking advantage of the connections they can utilize to maximize the return on their assets within a secure and flexible financial environment.

Connections is the word used to denote efforts in the Bank and its



Uma Umapathy, Manager Trade Services

"When clients call me back to express their appreciation, I feel especially good knowing my service is valued."

subsidiaries to make our customers aware of the range of services we now provide in Canada and throughout the world using our global links to other members of the HSBC Group. *Connections* is also part of our continuing effort to improve our service and do it in a more efficient and effective manner.

For example, throughout the year all employees were focused on becoming "smarter" bankers. Our "Smarter Banking" initiative has a major focus on improving service and eliminating unnecessary procedures or duplications. To date, more than 200 such recommendations have been implemented. Those changes have eliminated some routine tasks, and given our staff more time to build relationships with our customers.

The changes in what we do and how we do it are in response to a combination of factors. The first was the significant change in the regulatory regime imposed on financial services organizations. The barriers which kept each subsector separate from the others are essentially gone. Now we can offer one-stop shopping for almost all of our customers' financial services requirements.

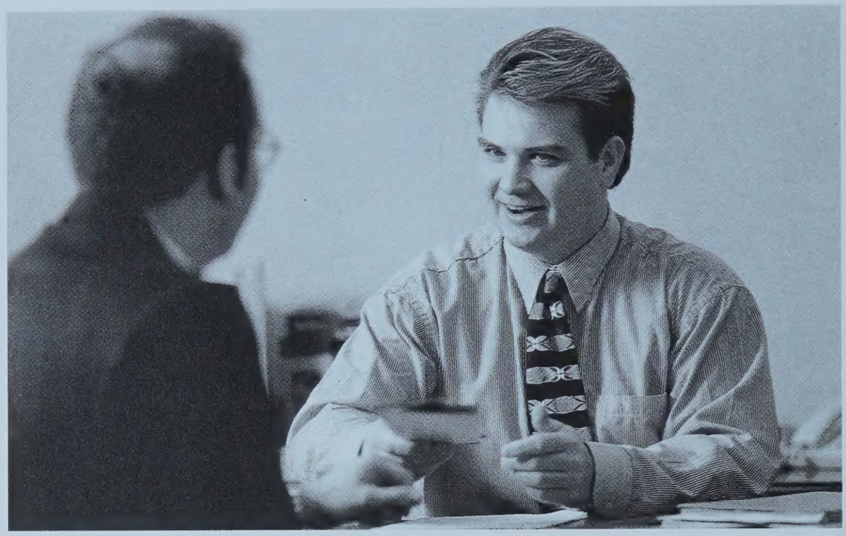
We are also equipping ourselves to deal with the changing reality of the market. For example, for the first time in history, there will be a significant transfer of wealth from one generation to another. With the changing demographics in Canada, a large portion of our population is moving into the stage in life

We invest in our people so our customers can be confident in investing with us.

Shawn Toporowski, Manager

Personal Financial Services

"I look at the customer's whole picture and then tailor a plan that will meet both the customer's financial and personal objectives."



where they will require advice on the management of their accumulated assets to meet their evolving financial objectives.

Moreover, as life expectancy continues to lengthen, the need for savings to supplement the Canada Pension Plan becomes ever more obvious. Individuals are seeking advice on how best to invest their retirement savings to maximize future income.

Individuals are becoming more sophisticated about their investments and the alternative choices they face. They want excellent thoughtful advice which is responsible, accountable and consistent. They need advice that recognizes that their financial needs and concerns change over time, that anticipates those needs and is available for consultation at a moment's notice.

The kind of financial services required by business is changing as well. Companies with corporate pension funds are seeking professional advice and pension fund administration. Moreover, as the economy continues to grow, companies both large and small are seeking alternatives to traditional bank funding for their continued operations and expansion. Whether a traditional loan, longer term financing, public or private placement of a bond or stock issue, or assistance in financing trade, companies need a place to go where financial advice will be tailored to their current and future needs. They require a financial services advisor who can provide the full range of services, both domestic and off-shore, and do it in a manner aimed at maximiz-

We identify emerging trends and anticipate the changing needs of our customers.

Creating connections: responsive, knowledgeable and tailored service.

ing the benefits to the customer. HSBC James Capel Canada Inc., HSBC Asset Management, HSBC Capital Canada Inc., and the commercial banking professionals within the Bank can provide our business customers with all the services they require.

To do this effectively is no easy task, and we are working to develop the capacity to anticipate what services and products our customers need. Then we need to ensure customers are looked after by skilled people who can provide in-depth product and service advice and expertise in both the commercial and personal financial services sectors.

We are confident this approach to business will allow us to retain and expand our customer base. We believe if we provide superior service to our customers, they will tell others about it and we will continue to earn our superior service reputation.

Unique to our Bank in Canada is our worldwide connection with the more than 5,500 offices of the HSBC Group in 79 countries and territories. For

Darlene Ferguson, Manager Personal Banking

"I keep abreast about what the competition is doing. It allows me to speak with customers confidently about how our services are really superior."

example, we have state-of-the-art technical expertise for handling millions of daily domestic and international transactions. The HSBC Group operates one of the largest proprietary networks of banking machines in the world. No matter where you travel, local currency is available at a nearby ABM. And, when it comes to investing in offshore mutual funds, we have on-site investment managers who know local markets, seek out the best investments and adjust portfolios as opportunities become available.

For our corporate customers, we offer a similar range of globe-spanning capabilities. Whether it is trade finance, (*Project & Trade Finance* magazine rated the HSBC Group as the best trade documentation bank in 1997), PC-based electronic banking facilities (our Hexagon service), foreign currency accounts, underwriting or term finance, Hongkong Bank of Canada together with the HSBC Group can provide contacts and relationships throughout the world. That means our customers are always dealing with the same financial services organization rather than a complex network of foreign banking correspondents.

Connections is the all-encompassing term that relates to what Hongkong Bank of Canada can do for our customers and how we meet their needs. It focuses everyone within the Bank towards the single goal of providing outstanding, innovative and imaginative service. It is a simple term with vast meaning.

Our first priority is to meet and exceed our customers' expectations.

Tom Ronneng, Manager Investment Services

"I show my customers the alternatives available to them – both the pros and the cons. I want them to know I have their best interest in mind."

Kristen Quilang,
Accounting Clerk
"I feel responsible for any referrals I make and I will follow up to make sure the customer has been taken care of."

Creating connections: building a position of strength.

Finally, effective April 1, 1998 I shall become Chief Executive Officer of Midland Bank plc, our Group affiliate in the United Kingdom. Youssef Nasr will assume the position of President and Chief Executive Officer of Hongkong Bank of Canada on January 1, 1998. I leave secure in the knowledge that the Bank's reputation for providing outstanding service, the cornerstone of our past success, will continue to be the guiding principle in the future. To demonstrate our continuity of commitment to our customers, Youssef joins me in signing this statement.

WILLIAM R.P. DALTON
PRESIDENT AND CHIEF EXECUTIVE OFFICER

YOUSSEF A. NASR
DEPUTY CHIEF EXECUTIVE OFFICER

DECEMBER 31, 1997
VANCOUVER, B.C.

Statement of Management's Responsibility for Financial Statements

The consolidated financial statements of Hongkong Bank of Canada have been prepared by, and are the responsibility of, the Bank's management. The presentation and information provided therein have been prepared in accordance with generally accepted accounting principles, including the accounting requirements of the Superintendent of Financial Institutions Canada ("the Superintendent"). The financial statements necessarily include amounts based on informed judgements and estimates of the expected effects of current events and transactions with appropriate consideration to materiality.

In meeting its responsibility for the reliability of financial information, management relies on comprehensive internal accounting, operating and system controls. The Bank's overall controls include an organizational structure providing for effective segregation of responsibilities, delegation of authority and personal accountability; written communication of policies and procedures of corporate conduct throughout the Bank and careful selection and training of personnel; the regular updating and application of written accounting and administrative policies and procedures necessary to ensure adequate internal control over transactions, assets and records; as well as a continued program of extensive internal audit covering all aspects of the Bank's operations. These controls are designed to provide reasonable assurance that financial records are reliable for preparing financial statements and maintaining accountability for assets, that assets are safeguarded against unauthorized use or disposition and that the Bank is in compliance with all regulatory requirements including compliance with the Canada Deposit Insurance Corporation ("CDIC") Standards of Sound Business & Financial Practices. Annually, the Bank completes the Standards Assessment and Reporting Program ("SARP") which details the Bank's compliance with the CDIC standards.

The Superintendent, at least once a year, makes such examination and enquiry into the affairs of the Bank as he feels necessary to satisfy himself that the provisions of the Bank Act, having reference to the safety of the deposits and the Shareholder of the Bank, are being duly observed and that the Bank is in a sound financial position.

The Board of Directors oversees management's responsibilities for financial statements through the Audit Committee, which is composed solely of directors who are not officers or employees of the Bank. The Audit Committee meets four times per year. During each year it reviews the adequacy of internal controls over accounting and financial reporting systems and discusses with the internal and external auditors the overall scope, timing and specific plans for their respective audits. The Audit Committee reviews with management and the Shareholder's auditors the content and format of the Bank's financial statements. As part of this process it reviews the adoption of and changes in accounting principles and practices that have a material effect on the Bank's financial statements and key management estimates and judgements material to those statements. The Committee also considers, for review by the Board and approval by the shareholder, the engagement or re-appointment of the Shareholder's auditors. The annual SARP is approved by the Board.

The Shareholder's auditors, the Bank's Vice-President and Chief Auditor and the Superintendent have full and free access to the Audit Committee to discuss audit, financial reporting and related matters.

W.R.P. Dalton
President and
Chief Executive Officer

J.T. Mould, C.M.A.
Chief Financial Officer

Auditors' Report

To the Shareholder of Hongkong Bank of Canada

We have audited the consolidated balance sheets of Hongkong Bank of Canada as at October 31, 1997 and 1996 and the consolidated statements of income, changes in shareholder's equity and changes in financial position for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Bank as at October 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles, including the accounting requirements of the Superintendent of Financial Institutions Canada.

KPMG

Chartered Accountants

Ernst & Young

Chartered Accountants

December 1, 1997
Vancouver, Canada

Consolidated Balance Sheets

as at October 31 (in millions of dollars)	1997	1996
Assets		
Cash resources:		
Cash and deposits with Bank of Canada	$ 172	$ 108
Deposits with regulated financial institutions	1,932	1,402
	2,104	1,510
Securities: (note 2)		
Issued or guaranteed by Canada and provinces	2,926	2,853
Other securities	279	100
	3,205	2,953
Loans: (notes 3 & 4)		
Commercial loans	7,940	7,139
Residential mortgage loans	6,876	6,453
Consumer loans	1,869	1,640
Allowance for credit losses	(231)	(221)
	16,454	15,011
Other:		
Customers' liability under acceptances	1,258	873
Land, buildings and equipment (note 5)	88	76
Other assets (note 6)	801	786
	2,147	1,735
	$ 23,910	$ 21,209

See notes to consolidated financial statements

Consolidated Balance Sheets

as at October 31 (in millions of dollars)	1997	1996
Liabilities		
Deposits: (note 7)		
Regulated financial institutions	$ 1,114	$ 156
Individuals	9,922	9,789
Businesses and governments	9,079	8,408
	20,115	18,353
Other:		
Acceptances	1,258	873
Other liabilities (note 8)	1,287	747
Non-controlling interest in subsidiary (note 9)	30	30
	2,575	1,650
Subordinated debt:		
Debentures (note 10)	549	583
Shareholder's equity:		
Capital stock (note 11)	75	75
Contributed surplus	165	165
Retained earnings	431	383
	671	623
	$ 23,910	$ 21,209

Approved by the Board:

Chairman of the Board

President and
Chief Executive Officer

Consolidated Statement of Income

for the years ended October 31 (in millions of dollars except per share amounts)	1997	1996
Interest and dividend income:		
Loans	**$ 984**	*$ 1,105*
Lease financing	**26**	*21*
Securities	**148**	*198*
Deposits with regulated financial institutions	**107**	*58*
Total interest and dividend income	**1,265**	*1,382*
Interest expense:		
Deposits	**729**	*857*
Debentures	**43**	*39*
Total interest expense	**772**	*896*
Net interest income	**493**	*486*
Provision for credit losses (note 4)	**38**	*53*
Net interest income after provision for credit losses	**455**	*433*
Other income (note 12)	**240**	*154*
Net interest and other income	**695**	*587*
Non-interest expenses:		
Salaries and employee benefits	**230**	*188*
Premises and equipment expenses, including depreciation	**72**	*63*
Other	**172**	*149*
Total non-interest expenses	**474**	*400*
Income before provision for income taxes	**221**	*187*
Provision for income taxes (note 14)	**83**	*69*
Net income	**$ 138**	*$ 118*
Average number of shares outstanding	**280,168,000**	*280,168,000*
Net income per share	**$ 0.49**	*$ 0.42*

See notes to consolidated financial statements

Consolidated Statement of Changes in Shareholder's Equity

for the years ended October 31 (in millions of dollars)		1997		1996
Capital stock: (note 11)				
Balance at beginning and end of year	$	75	$	75
Contributed surplus: (note 1(f))				
Balance at beginning of year	$	165	$	160
Net recoveries on loans		–		1
Other		–		4
Balance at end of year	$	165	$	165
Retained earnings:				
Balance at beginning of year	$	383	$	340
Net income		138		118
Dividend on common shares		(90)		(75)
Balance at end of year	$	431	$	383

See notes to consolidated financial statements

Consolidated Statement of Changes in Financial Position

for the years ended October 31 (in millions of dollars)	1997	1996
Cash resources provided from (used in) operating activities:		
Net income	**$ 138**	*$ 118*
Adjustments to determine cash resources provided from operating activities:		
Provision for credit losses (note 4)	**38**	*53*
Provision for deferred income taxes (note 14)	**26**	*–*
Depreciation and amortization	**31**	*24*
Change in net accrued interest	**15**	*29*
Net decrease (increase) in other assets, net of accrued interest receivable	**36**	*(102)*
Net increase in other liabilities, net of accrued interest payable	**435**	*130*
Other items, net	**(23)**	*1*
	696	*253*
Cash resources provided from (used in) financing activities:		
Net increase (decrease) in deposits from regulated financial institutions	**958**	*(242)*
Net increase in deposits from individuals	**133**	*412*
Net increase in deposits from business and governments	**632**	*851*
Issue of bank debentures	**–**	*60*
Dividends paid	**(90)**	*(75)*
	1,633	*1,006*
Cash resources provided from (used in) investing activities:		
Businesses acquired	**–**	*(47)*
Net (increase) decrease in securities	**(252)**	*158*
Net (increase) in commercial loans	**(801)**	*(329)*
Net (increase) in residential mortgage loans	**(423)**	*(594)*
Net (increase) in consumer loans	**(229)**	*(157)*
Net (increase) in land, buildings, and equipment	**(30)**	*(27)*
	(1,735)	*(996)*
Net increase in cash resources	**594**	*263*
Cash resources in businesses acquired at date of acquisition	**–**	*58*
Cash resources at beginning of year	**1,510**	*1,189*
Cash resources at end of year	**$ 2,104**	*$ 1,510*

See notes to consolidated financial statements

October 31, 1997 and 1996 (all tabular amounts are in millions of dollars)

Hongkong Bank of Canada ("the Bank") is a wholly owned subsidiary of HSBC Holdings BV and, as a result, is an indirectly held, wholly owned subsidiary of HSBC Holdings plc ("the Parent").

1. ACCOUNTING POLICIES:

These consolidated financial statements have been prepared in accordance with generally accepted accounting policies, including the accounting requirements of the Superintendent of Financial Institutions Canada ("the Superintendent"). Certain prior year amounts have been reclassified to conform with current year presentation. The significant accounting policies used in the preparation of these financial statements are summarized below.

a) Basis of consolidation:

The assets and liabilities and results of operations of the Bank and its subsidiaries are reported in the financial statements on a consolidated basis. All material intercompany transactions have been eliminated. The difference between the cost of investments in subsidiary companies and the fair values of net assets acquired is attributed to goodwill and recorded in other assets. Goodwill is amortized over the estimated period of benefit except where there is a decline in value considered to be other than temporary.

b) Deposits with regulated financial institutions:

Deposits with regulated financial institutions are recorded at cost. Interest income on interest bearing deposits is recorded on an accrual basis.

c) Securities:

Investment account securities, where the Bank's intention is to hold the securities to maturity or until market conditions render alternative investments more attractive, are carried at cost or amortized cost. If the securities held for investment account experience a decline in value that is other than temporary, the carrying value is appropriately reduced. The amortization of premiums and discounts and adjustments to the carrying value of securities are included in other income in the consolidated statements of income. Gains and losses on the disposal of securities are included in other income. Previously, the amounts were recorded in income from securities.

Trading account securities, which are purchased for resale over a short period of time, are carried at market value. Gains and losses on disposal or revaluation are included in other income. Previously, the amounts above were recorded in income from securities.

Loan substitute securities are customer financings structured as after-tax investments to provide the borrower with an interest rate advantage over what would otherwise be applicable on a conventional loan. Such securities are accorded the accounting treatment applicable to loans.

d) Loans:

Loans are stated net of any unearned income, unamortized premiums or discounts and an appropriate allowance for credit losses.

Interest income is recorded on the accrual basis unless the loan is classified as an impaired loan. Loans are considered to be impaired whenever there is no longer reasonable assurance as to the ultimate collectibility of some portion of principal or interest. Loans where interest is due and has not been collected for a period of 90 days are automatically recognized as impaired, unless management determines there is no reasonable doubt as to the ultimate collectibility of principal and interest. Loans where interest is due and has not been collected for a period of 180 days are automatically classified as impaired.

Impaired loans are recorded at their estimated realizable amounts by discounting the expected future cash flows at the effective interest rate inherent in the loans except when the amounts and timing of future cash flows cannot be estimated with reasonable reliability, in which case estimated realizable amounts are measured at the fair value of any security underlying the loans, net of expected costs of realization. When a loan is classified as impaired, recognition of interest in accordance with the terms of the original loan agreement ceases. Subsequent payments (interest or principal) received on an impaired loan are recorded as a reduction of the recorded investment in the loan. Interest income is recognized only when all allowances for credit losses have been reversed.

Fees associated with lending activities are deferred and amortized over the term of the loans, and are included in income from loans in the consolidated statement of income.

e) Direct finance leases:

Direct finance leases are included in commercial and other loans in the balance sheets. Initial direct costs of direct finance leases are expensed as incurred. The investment in the lease is defined as the minimum lease payments receivable, including the purchase option price, less unearned income.

f) Allowance for credit losses:

The Bank maintains an allowance for credit losses which is considered adequate to absorb all credit related losses in its

portfolio of both on- and off-balance sheet items, including deposits with other regulated financial institutions, loan substitute securities, loans, acceptances, derivative instruments and other credit-related contingent liabilities, such as letters of credit and guarantees.

The allowance for credit losses includes specific allowances against specific credit exposures determined on an item by item basis, being the amount required to reduce the carrying value of an impaired asset to its net realizable amount, and general allowances for doubtful credits, being provisions of a prudential nature on the aggregate exposures for which specific provisions cannot yet be determined. In prior years, the provision for doubtful credits was established against exposures to particular industries or geographic regions.

The provision for credit losses, excluding the allowance on those loans acquired from the Bank of British Columbia, comprises the amounts written off during the year, net of recoveries on amounts written off in prior years, and changes in provisions. This amount is charged to the consolidated statement of income. Losses and recoveries on certain loans acquired from the Bank of British Columbia are charged or credited to contributed surplus as prescribed by the Superintendent.

g) Land, buildings and equipment:

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation. Leasehold improvements are amortized over the original term of the leases plus one renewal period, using the straight-line method. Gains and losses on disposal of fixed assets are recorded in the consolidated statement of income in the year of disposal.

h) Income taxes:

The Bank follows the tax allocation basis of accounting for income taxes, whereby income taxes on specific transactions are recorded in the period in which the transactions are recognized for accounting purposes regardless of when the transactions are recognized for tax purposes. Deferred income taxes are provided to recognize the effect of timing differences for those items of income and expense that may affect income for tax purposes in a period different from that in which they affect income for accounting purposes.

i) Pension and other post-retirement employee benefits:

The Bank has two defined benefit pension plans for employees based on years of service and average earnings prior to retirement and a non-contributory defined contribution plan. Pension costs and obligations are determined using management's best estimates of various assumptions, such as projected employee compensation levels and rates of return on investments. The Bank also provides certain health care and life insurance benefits for employees after retirement. The cost of these benefits is expensed as incurred.

j) Translation of foreign currencies:

Assets and liabilities in foreign currencies are translated into Canadian dollars at year-end spot exchange rates. Revenues and expenses in foreign currencies are translated into Canadian dollars at the rates in effect at the transaction date. Premiums and discounts on foreign currency forward contracts that hedge foreign currency assets and liabilities are amortized over the period to maturity as interest expense in the consolidated statement of income. Realized and unrealized gains and losses from foreign currency translation are included in other income in the consolidated statement of income.

k) Derivative instruments:

The Bank enters into various derivative contracts including foreign exchange contracts, interest rate and cross currency swaps, financial futures contracts and forward rate agreements in order to manage the risks associated with changes in interest and foreign exchange rates, to meet customer needs and to earn trading income. The net income or expense related to transactions used in managing the Bank's interest rate exposure is recognized on an accrual basis over the term of the agreement as an adjustment to interest expense in the consolidated statement of income. The net income or expense related to transactions used in managing the Bank's foreign exchange exposure is recognized on a mark to market basis as is the corresponding foreign currency asset or liability and recorded as an adjustment to other income in the consolidated statement of income. The net income or expense related to transactions entered into for trading purposes and for customer related transactions is recorded on a mark to market basis and recognized as other income in the consolidated statement of income. The Canadian Institute of Chartered Accountants Handbook Section 3860 "Presentation and Disclosure of Financial Instruments" was adopted in full during the year. As a result, unrealized gains and losses on derivative instruments previously recorded on a net basis are now included in other assets and liabilities on a gross basis. Prior years have not been restated to give effect to this change.

l) Trust assets under administration:

Trust assets under administration are maintained separately from the Bank's assets and are not included in the Consolidated Balance Sheets.

2. SECURITIES:

	Term to maturity Within 1 Year	1-5 Years	5-10 Years	No Specific Maturity	**Total Carrying Value 1997**	Total Carrying Value 1996
Investment securities						
Securities issued or guaranteed by:						
Canada	$ 1,463	$ 898	$ 14	$ –	**$ 2,375**	$ 2,666
Provinces	252	41	12	–	**305**	75
	1,715	939	26	–	**2,680**	2,741
Debt of foreign issuer	–	–	–	–	**–**	36
Mutual funds	–	–	–	6	**6**	14
Equity securities	–	42	–	18	**60**	39
Total investment securities	1,715	981	26	24	**2,746**	2,830
Loan substitute securities	–	3	–	–	**3**	9
Trading securities	309	–	–	147	**456**	114
Total securities	$ 2,024	$ 984	$ 26	$ 171	**$ 3,205**	$ 2,953

Included in trading securities are $246 million of securities issued or guaranteed by Canada (1996 - $112 million).

Analysis of unrealized gains and losses on investment securities

	Carrying Value 1997	Gross Unrealized Gains	Gross Unrealized Losses	**Estimated Market Value 1997**	Estimated Market Value 1996
Securities issued or guaranteed by:					
Canada	$ 2,375	$ 21	$ (1)	**$ 2,395**	$ 2,695
Provinces	305	3	–	**308**	76
	2,680	24	(1)	**2,703**	2,771
Debt of foreign issuers	–	–	–	**–**	36
Mutual funds	6	–	–	**6**	15
Equity securities	60	12	–	**72**	50
	$ 2,746	$ 36	$ (1)	**$ 2,781**	$ 2,872

3. LOANS:

	1997	1996
Commercial loans:		
Real estate	$ 2,978	$ 2,651
Hotels and hospitality	810	478
Manufacturing	961	1,168
Trade	1,794	1,815
Services	762	477
Direct finance leases	327	351
Other	308	199
Total commercial loans	7,940	7,139
Residential mortgages	6,876	6,453
Consumer loans	1,869	1,640
Allowance for credit losses	(231)	(221)
	$ 16,454	$ 15,011

As a result of acquisitions in previous years of ANZ Bank Canada and Metropolitan Trust Company of Canada ("MetTrust"), the Bank has recourse to the vendors or their related parties for certain performing loans which become non-accrual. At October 31, 1997 the amount of loans with recourse aggregated $53 million. The recourse on $6 million relating to ANZ Bank Canada and $47 million relating to MetTrust expires in 1998 and 2000 respectively. In addition, a related party to the vendor of MetTrust has agreed to manage any litigation regarding recourse loans which is attributable to matters arising prior to acquisition and has indemnified MetTrust for any losses and related costs.

4. IMPAIRED ASSETS AND ALLOWANCE FOR CREDIT LOSSES:

a. The Bank's investment in impaired assets and the related specific allowances are as follows:

	Gross Amount	Specific Allowances	1997 Carrying Amount	1996 Carrying Amount
Commercial loans:				
Real estate	$ 44	$ 21	$ 23	$ 52
Manufacturing	18	8	10	5
Trade	22	11	11	11
Services	12	6	6	9
Other	28	20	8	2
Consumer loans	12	9	3	3
Residential mortgages	25	–	25	13
	$ 161	$ 75	$ 86	$ 95

Impaired assets include foreclosed real estate assets held for sale with a gross carrying value of $0.6 million (1996 - $16 million) and a related allowance of $0.5 million (1996 - $8 million).

As a result of the acquisition in prior years of ANZ Bank Canada, $14 million (1996 - $28 million) of impaired loans are supported by an interest-free deposit of the same amount.

b. The Bank's allowance for credit losses is as follows:

		Beginning balance		Provision for credit losses		Write-Offs		Recoveries and other		1997 Ending balance
Specific allowances:										
Commercial loans:										
Real estate	$	23	$	7	$	(9)	$	–	$	**21**
Manufacturing		12		–		(4)		–		**8**
Trade		17		(4)		(2)		–		**11**
Services		8		(1)		(1)		–		**6**
Other		15		10		(5)		–		**20**
Consumer loans		12		3		(6)		–		**9**
Residential mortgages		1		1		(2)		–		**–**
Total specific allowances		88		16		(29)		–		**75**
General allowance [1]		133		22		–		1		**156**
Total	$	221	$	38	$	(29)	$	1	$	**231**

(1) The Bank's general allowance has been established to absorb losses in the Bank's total loan portfolio for which specific provisions cannot yet be determined. Accordingly, the general allowance has not been applied to reduce the carrying value of specific impaired assets shown in the table in note 4(a) above.

5. LAND, BUILDINGS AND EQUIPMENT:

		Cost		Accumulated depreciation and amortization		**Net book value 1997**		Net book value 1996
Land and buildings	$	8	$	2	$	**6**	$	8
Furniture and equipment		63		38		**25**		19
Computer equipment		52		35		**17**		14
Leasehold improvements		71		31		**40**		35
	$	194	$	106	$	**88**	$	76

Depreciation and amortization charged to income in respect of the above amounted to $18 million (1996 - $15 million).

6. OTHER ASSETS:

		1997		1996
Accrued interest receivable	$	**248**	$	184
Cheques and other items in transit, net		**9**		424
Deferred pension benefits		**10**		11
Due from clients, dealers and clearing corporations		**293**		82
Unrealized gains on derivative instruments		**172**		13
Accounts receivable and other		**69**		72
	$	**801**	$	786

7. DEPOSITS:

	Regulated financial institutions	Individuals	Businesses and governments	Total 1997	Total 1996
Demand	*$ 33*	*$ –*	*$ 692*	**$ 725**	*$ 655*
Notice	*–*	*2,500*	*1,283*	**3,783**	*3,904*
Fixed date	*1,081*	*7,422*	*7,104*	**15,607**	*13,794*
	$ 1,114	*$ 9,922*	*$ 9,079*	**$ 20,115**	*$ 18,353*

8. OTHER LIABILITIES:

	1997	1996
Accrued interest payable	**$ 335**	*$ 256*
Deferred income taxes and other taxes payable	**14**	*15*
Mortgages sold with recourse	**246**	*176*
Payable to clients, dealers and clearing corporations	**311**	*102*
Unrealized losses on derivative instruments	**95**	*–*
Accounts payable and other	**286**	*198*
	$ 1,287	*$ 747*

9. NON-CONTROLLING INTEREST IN SUBSIDIARY:

HongkongBank Mortgage Corporation has issued $30 million of class B perpetual preferred shares to HSBC Holdings BV. No dividends were paid or payable on these perpetual preferred shares for the years ended October 31, 1997 and 1996. Dividends may be declared at the discretion of the directors of HongkongBank Mortgage Corporation.

10. DEBENTURES:

Debentures, which are unsecured and subordinated in right of payment to the claims of depositors and certain other creditors, comprise:

Interest rate %	Year of maturity	Foreign Currency amount	1997	1996
Issued to HSBC Holdings plc Group Companies				
90 day bankers' acceptance rate plus 0.50% (1)	*2002*		**$ 60**	*$ 60*
5.84 (2)	*2091*		**185**	*185*
6.84 (3)	*2094*	*US$85*	**119**	*114*
8.29 (4)	*2094*		**25**	*25*
			389	*384*
Issued to others				
90 day bankers' acceptance rate plus 0.32% (5)	*1999*		**–**	*39*
7.70 (6)	*2011*		**60**	*60*
11.00 (7)	*2005*		**60**	*60*
30 day bankers' acceptance rate plus 0.50%	*2083*		**40**	*40*
			160	*199*
Total			**$ 549**	*$ 583*

(1) The interest rate was fixed at 7.92% until October 16, 1997 and thereafter the rate reprices at the 90 day average bankers' acceptance rate plus 0.50%.
(2) The interest rate was fixed at 7.92% until October 16, 1997 at which date the rate repriced at 5.84% until October 2002. Thereafter the rate reprices every 5 years at the then Government of Canada 5 year bond rate plus 0.70%.
(3) The interest rate is fixed at 6.84% until July 2000 and thereafter the rate reprices every 5 years at the then 5 year U.S. Treasury rate plus 0.80%
(4) The interest rate is fixed at 8.29% until October 2000 and thereafter the rate reprices every 5 years at the then Government of Canada 5 year bond rate plus 0.70%.
(5) On October 31, 1997 the $39 million debentures due in 1999 were converted to deposits.
(6) The interest rate is fixed at 7.70% until February 2006 and thereafter the rate reprices at the 90 day average bankers' acceptance rate plus 1.00%
(7) This debenture maturing 2005 was an obligation of Barclays Bank of Canada assumed by the Bank effective August 31, 1996 (note 22).

Interest expense for the year relating to debentures issued to Group companies amounted to $29.5 million (1996 - $29.6 million).

On November 6, 1997 the Bank issued a $60 million 12 year debenture due in 2009. The interest rate is fixed at 5.73% until November 2004 and thereafter reprices at the 90 day average bankers' acceptance rate plus 1.00%.

11. CAPITAL STOCK:

Authorized:

The authorized capital of the Bank is 994,117,500 shares without par value made up of 993,677,000 common shares and 440,500 special shares.

Issued and fully paid:

	Number of common shares	Amount
At October 31, 1997 and 1996	*280,168,000*	*$ 75*

12. OTHER INCOME:

	1997	1996
Investment and securities services	**$ 89**	*$ 43*
Deposit and payment services	**46**	*42*
Lending fees	**23**	*14*
Bankers' acceptance, letter of credit and guarantee fees	**31**	*25*
Trading revenue	**34**	*22*
Other	**17**	*8*
	$ 240	*$ 154*

13. PENSION PLANS:

Information with respect to the Bank's defined benefit pension plans for employees as at January 1, 1997 and 1996 is as follows:

	1997	1996
Pension fund assets, at estimated market value	**$ 132**	*$ 118*
Actuarially computed present value of accrued pension benefits	**81**	*87*
	$ 51	*$ 31*

14. INCOME TAXES:

Provisions for income taxes included in the consolidated statement of income are:

	1997	1996
Current	**$ 57**	*$ 69*
Deferred	**26**	–
	$ 83	*$ 69*

The provisions for income taxes shown in the consolidated statement of income are less than that obtained by applying statutory tax rates to the net income before provision for income taxes for the following reasons:

	1997	1996
Combined federal and provincial income tax rate	**44.76%**	*44.81%*
Decrease resulting from:		
Adjustment for tax exempt income related to preferred shares, common shares, and income debentures	**(6.31)**	*(6.25)*
Utilization of tax losses carried forward and other deductions	**(3.48)**	*(2.06)*
Other, net	**2.61**	*0.40*
	37.58%	*36.90%*

15. LONG-TERM LEASE COMMITMENTS:

Future minimum commitments under long-term leases of premises are as follows:

1998	*$ 25*
1999	*25*
2000	*23*
2001	*22*
2002	*19*
2003 and thereafter	*93*
	$ 207

The total rental expense charged in respect of premises for the year was $29 million (1996 - $27 million).

16. GUARANTEES AND LETTERS OF CREDIT:

The Bank issues guarantees and letters of credit to meet credit requirements of its customers. The amounts are not included in the consolidated balance sheets and are as follows:

	1997	1996
Guarantees	**$ 482**	*$ 556*
Letters of credit	**263**	*180*
	$ 745	*$ 736*

In the event of a call on the above commitments, the Bank has recourse against the customer.

17. CONTINGENCIES:

The Bank is subject to a number of legal claims and other contingencies arising in the normal course of its business. Defendants in certain class action and shareholder suits have filed third party complaints against the Bank. Management believes these third party complaints are without merit and will vigorously defend these complaints. Management is of the opinion that adequate provision has been made for any potential liability.

A Bank subsidiary is subject to threatened action relating to its responsibilities as a distributor, escrow agent and custodian. Management has reviewed this matter and is of the opinion that the possibility of material liability is unlikely. Accordingly, no provision has been recorded in the financial statements relating to this matter.

The Bank has various matters under discussion with taxation authorities which, if confirmed, would result in a reversal of certain previously recorded liabilities.

18. FAIR VALUE OF FINANCIAL INSTRUMENTS:

The amounts below represent the fair values of the Bank's on- and off-balance sheet financial instruments. Fair value is the estimated amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

	1997		
	Book Value	**Fair Value**	**Fair Value over (under) book value**
Assets			
Cash resources	*2,104*	*2,104*	–
Securities	*3,205*	*3,240*	*35*
Loans	*16,454*	*16,561*	*107*
Other assets	*2,059*	*2,059*	–
Liabilities			
Deposits	*20,115*	*20,180*	*65*
Other liabilities	*2,575*	*2,575*	–
Subordinated debt	*549*	*579*	*30*
Off-balance sheet	*77*	*33*	*(44)*

The determination of fair values of financial instruments for which there are no quoted market values requires that a number of assumptions are made for which there exists a significant degree of subjectivity.

The following methods and assumptions were used to estimate the fair value of these financial instruments:

– Cash resources, Other assets and Other liabilities, due to their short term nature, are assumed to approximate their carrying values.

– Securities are assumed to be equal to the estimated market value of securities based on quoted market prices where available. If quoted market prices are not available, fair values are estimated using quoted market prices of similar securities or other valuation techniques.

– Floating rate and consumer loans are assumed to be equal to their book value. The fair value of commercial and residential mortgage and loans with fixed terms are estimated using a discounted cash flow calculation at current rates for loans with similar terms and credit risks.

– Demand deposits are assumed to be equal to their carrying value. The fair value of other deposits are estimated using a discounted cash flow calculation at market rates.

– Subordinated debt is determined by reference to current market prices for debt with similar terms and risks.

19. DERIVATIVE INSTRUMENTS:

In the ordinary course of business, the Bank enters into various derivative contracts such as foreign exchange contracts, interest rate swaps, forward rate agreements and financial futures contracts whose notional principal is not included in the consolidated balance sheets.

Derivatives are contracts whose value is derived from an underlying asset or an underlying reference rate or index such as interest or foreign exchange rates. The Bank uses derivatives for both trading and asset/liability management purposes.

Trading related activity includes transactions undertaken on behalf of the Bank and its customers ("Trading"). Asset/liability management derivatives are used by the Bank to manage its exposures to interest rate and foreign currency fluctuations and where appropriate the Bank may use customer related trading transactions as part of its asset/liability management ("ALM") program.

The Bank strictly adheres to its formalized risk management policies and procedures. Risk limits are determined for each portfolio of derivative instruments based on product, currency, interest rate repricing and market volatility. All limits are monitored on a daily basis.

Derivative instruments are subject to both market risk and credit risk. Market risk is the risk that the fair value of derivatives will fluctuate due to changes in interest and foreign exchange rates. Market risk is managed on a consolidated Bank basis.

Credit risk for derivative instruments is not equal to the notional amount of the principal as it is with assets recorded on the balance sheets. The credit risk for derivatives is principally the replacement cost of any contract with a positive market value including an estimate for future fluctuation risk. Credit risk for derivatives is managed using risk management policies set out in note 24.

a) An analysis of the Bank's derivative portfolio and related credit exposure at October 31 is as follows:

	1997				1996			
	Notional Amount	**Current Replacement Cost**	**Credit Equivalent Amount**	**Risk Weighted Balance**	Notional Amount	Current Replacement Cost	Credit Equivalent Amount	Risk Weighted Balance
Interest rate contracts:								
Forward rate agreements	**$ 2,942**	**$ –**	**$ –**	**$ –**	*$ 2,730*	*$ 3*	*$ 3*	*$ 1*
Futures – exchange traded	**3,863**	**–**	**–**	**–**	*2,242*	*3*	*–*	*–*
Swaps	**11,100**	**59**	**87**	**36**	*9,391*	*49*	*72*	*17*
	17,905	**59**	**87**	**36**	*14,363*	*55*	*75*	*18*
Foreign exchange contracts:								
Spot contracts	**1,012**	**1**	**–**	**–**	*1,002*	*1*	*–*	*–*
Forward contracts	**10,617**	**143**	**267**	**71**	*11,458*	*73*	*182*	*51*
	11,629	**144**	**267**	**71**	*12,460*	*74*	*182*	*51*
Equity futures contracts	**151**	**4**	**13**	**7**	*–*	*–*	*–*	*–*
Total	**$29,685**	**$ 207**	**$ 367**	**$ 114**	*$26,823*	*$ 129*	*$ 257*	*$ 69*

Notional amounts are the contract amounts used to calculate the cash flows to be exchanged. They are a common measure of volume of outstanding transactions, but do not represent credit or market risk exposure.

Current replacement cost represents the estimated cost of replacing, at current market rates, all contracts with a positive value.

Credit equivalent amount is the current replacement cost plus an amount for future credit exposure associated with the potential for future changes in currency and interest rates. The future credit exposure is calculated using a formula prescribed by the Superintendent in its capital adequacy guidelines.

Risk-weighted balance represents the amount based upon which the regulatory capital required to support the Bank's derivative activities is calculated. It is derived from risk weighting the credit equivalent amounts according to the creditworthiness of the counterparties using factors prescribed by the Superintendent in its capital adequacy guidelines.

b) The following table summarizes the notional amounts by remaining term to maturity of the Bank's derivative portfolio at October 31, segregating derivative instruments between those entered into by the Bank from its trading activities and those used to manage the risk associated with changes in interest and foreign exchange rates as part of the Bank's ALM program.

	Customer and Proprietary Trading				ALM				Total
	1997				1997				1997
	Under 1 year	1 - 5 years	Over 5 Years	Total Trading	Under 1 year	1 - 5 years	Over 5 years	Total ALM	Total
Interest rate contracts:									
Forward rate agreements	$ 2,942	$ –	$ –	$ 2,942	$ –	$ –	$ –	$ –	$ 2,942
Futures – exchange traded	2,959	200	–	3,159	704	–	–	704	3,863
Swaps	3,922	1,671	–	5,593	3,088	2,347	72	5,507	11,100
	9,823	1,871	–	11,694	3,792	2,347	72	6,211	17,905
Foreign exchange contracts:									
Spot contracts	822	–	–	822	190	–	–	190	1,012
Forward contracts	5,463	270	–	5,733	4,884	–	–	4,884	10,617
	6,285	270	–	6,555	5,074	–	–	5,074	11,629
Equity futures contracts	151	–	–	151	–	–	–	–	151
Total	$16,259	$ 2,141	$ –	$18,400	$ 8,866	$ 2,347	$ 72	$11,285	$29,685

	Customer and Proprietary Trading				ALM				Total
	1996				1996				1996
	Under 1 year	1 - 5 years	Over 5 Years	Total Trading	Under 1 year	1 - 5 years	Over 5 years	Total ALM	Total
Interest rate contracts:									
Forward rate agreements	$ 2,730	$ –	$ –	$ 2,730	$ –	$ –	$ –	$ –	$ 2,730
Futures – exchange traded	1,985	25	–	2,010	232	–	–	232	2,242
Swaps	1,460	709	24	2,193	4,450	2,667	81	7,198	9,391
	6,175	734	24	6,933	4,682	2,667	81	7,430	14,363
Foreign exchange contracts:									
Spot contracts	701	–	–	701	301	–	–	301	1,002
Forward contracts	8,211	319	–	8,530	2,928	–	–	2,928	11,458
	8,912	319	–	9,231	3,229	–	–	3,229	12,460
Equity futures contracts	–	–	–	–	–	–	–	–	–
Total	$15,087	$ 1,053	$ 24	$16,164	$ 7,911	$ 2,667	$ 81	$10,659	$26,823

c) The following table summarizes the fair value, as represented by the sum of the net unrealized gains and losses, accrued interest receivable and payable and premiums paid or received, of the Bank's derivative portfolio at October 31, segregating derivative instruments between Trading and ALM and between those that are in a favourable or receivable position from those in an unfavourable or payable position. The favourable net position of the ALM portfolio shown in the table below is offset by a reduction in the underlying fair values of the assets and liabilities hedged.

Trading derivatives are marked to market on a daily basis and the net position for the trading portfolio shown in the table below has already been recognized in the financial statements. ALM interest rate derivatives are accounted for on the accrual basis and the net income or expense is recognized over the life of the derivative contract. Foreign exchange derivatives used for ALM purposes are accounted for on a mark to market basis as are the underlying assets and liabilities hedged and the net position shown in the table below has already been recognized in the financial statements. The ALM portfolio is used to manage the Bank's exposure to changes in interest and foreign currency rates.

Fair values of derivative instruments are determined using quoted market prices.

	Customer and Proprietary Trading 1997			ALM 1997			Total Net
	Favourable Position	(Unfavourable) Position	Net Position	Favourable Position	(Unfavourable) Position	Net Position	1997
Interest rate contracts:							
Forward rate agreements	$ –	$ (1)	$ (1)	$ –	$ –	$ –	$ (1)
Futures	–	–	–	–	–	–	–
Swaps	24	(31)	(7)	35	(79)	(44)	(51)
	24	(32)	(8)	35	(79)	(44)	(52)
Foreign exchange contracts:							
Spot contracts	1	–	1	–	–	–	1
Forward contracts	57	(60)	(3)	86	(3)	83	80
	58	(60)	(2)	86	(3)	83	81
Equity futures contracts	4	–	4	–	–	–	4
Total	$ 86	$ (92)	$ (6)	$ 121	$ (82)	$ 39	$ 33

	Customer and Proprietary Trading 1996			ALM 1996			Total Net
	Favourable Position	(Unfavourable) Position	Net Position	Favourable Position	(Unfavourable) Position	Net Position	1996
Interest rate contracts:							
Forward rate agreements	$ 3	$ (4)	$ (1)	$ –	$ –	$ –	$ (1)
Futures	3	(3)	–	–	(1)	(1)	(1)
Swaps	17	(23)	(6)	32	(115)	(83)	(89)
	23	(30)	(7)	32	(116)	(84)	(91)
Foreign exchange contracts:							
Spot contracts	1	(1)	–	–	–	–	–
Forward contracts	67	(71)	(4)	6	(36)	(30)	(34)
	68	(72)	(4)	6	(36)	(30)	(34)
Equity futures contracts	–	–	–	–	–	–	–
Total	$ 91	$ (102)	$ (11)	$ 38	$ (152)	$ (114)	$ (125)

20. INTEREST RATE SENSITIVITY POSITION:

The following table provides an analysis of the Bank's interest rate sensitivity position at October 31, 1997 based on contractual repricing dates of assets and liabilities:

	Within 3 months	3 to 6 months	6 to 12 months	Effective Interest Rate (%)	Greater than 1 year	Effective Interest Rate (%)	Non-Interest Sensitive	Total
Cash resources	*$ 1,445*	*$ 94*	*$ 258*	*3.9*	*$ –*	*–*	*$ 307*	*$ 2,104*
Securities	*1,172*	*607*	*234*	*4.0*	*1,023*	*7.0*	*169*	*3,205*
Loans	*8,573*	*1,292*	*1,600*	*5.4*	*5,057*	*7.0*	*(68)*	*16,454*
Other assets	*–*	*–*	*–*	*–*	*–*	*–*	*2,147*	*2,147*
Total assets	*11,190*	*1,993*	*2,092*	*–*	*6,080*	*–*	*2,555*	*23,910*
Deposits	*14,300*	*1,632*	*2,744*	*3.4*	*747*	*6.2*	*692*	*20,115*
Other liabilities	*–*	*–*	*–*	*–*	*–*	*–*	*2,575*	*2,575*
Subordinated debt	*100*	*–*	*–*	*4.4*	*449*	*7.2*	*–*	*549*
Shareholder's equity	*–*	*–*	*–*	*–*	*–*	*–*	*671*	*671*
Total liabilities & shareholder's equity	*14,400*	*1,632*	*2,744*	*–*	*1,196*	*–*	*3,938*	*23,910*
On balance sheet gap	*(3,210)*	*361*	*(652)*	*–*	*4,884*	*–*	*(1,383)*	*–*
Off balance sheet positions	*3,132*	*(412)*	*(1,304)*	*–*	*(1,416)*	*–*	*–*	*–*
Total interest rate gap	*$ (78)*	*$ (51)*	*$ (1,956)*	*–*	*$ 3,468*	*–*	*$ (1,383)*	*$ –*

An immediate and sustained parallel increase in interest rates of 1% across all currencies and maturities would reduce net interest income by $5 million (1996 - $3 million) over the next twelve months assuming no additional hedging is undertaken.

In managing interest rate risk, the Bank relies primarily upon its contractual interest rate sensitivity position adjusted for certain assumptions regarding customer behavioural preferences which are based upon historical trends. Adjustments made include assumptions relating to early repayment of consumer loans and residential mortgages and customer preferences for demand, notice and redeemable deposits. Based upon these adjustments, it is estimated that an immediate and sustained parallel increase in interest rates of 1% across all currencies and maturities would increase net interest income by $3 million (1996 - $2 million) over the next twelve months assuming no additional hedging.

21. SEGMENTED INFORMATION:

Assets:

An analysis of the Bank's assets on the basis of the location of ultimate risk is as follows:

	1997		1996	
	Amount	**Percent**	Amount	Percent
Canada	**$ 22,850**	**95.6**	*$ 20,324*	*95.8*
United States	**899**	**3.8**	*576*	*2.7*
Hong Kong SAR	**40**	**0.1**	*39*	*0.2*
Other	**121**	**0.5**	*270*	*1.3*
	$ 23,910	**100.0**	*$ 21,209*	*100.0*

Liabilities:

An analysis of the Bank's deposit, acceptances and other liabilities on the basis of the residence status of the bearer of the liabilities is as follows:

	1997		1996	
	Amount	**Percent**	Amount	Percent
Canada	**$ 17,732**	**78.2**	*$ 16,750*	*83.9*
United States	**1,880**	**8.3**	*317*	*1.6*
Hong Kong SAR	**2,375**	**10.5**	*2,446*	*12.2*
Other	**673**	**3.0**	*460*	*2.3*
	$ 22,660	**100.0**	*$ 19,973*	*100.0*

Total interest and dividend income:

An analysis of the total interest and dividend income on the basis of geographic location is as follows:

	1997		1996	
	Amount	**Percent**	Amount	Percent
Domestic	**$ 1,171**	**92.6**	*$ 1,316*	*95.2*
International	**94**	**7.4**	*66*	*4.8*
Total	**$ 1,265**	**100.0**	*$ 1,382*	*100.0*

22. BUSINESS ACQUISITIONS:

The Bank completed two acquisitions during 1996.

On May 3, 1996 the Bank acquired all of the common shares of M.K. Wong and Associates Ltd., an asset management company. Pursuant to letters patent issued by the Minister of Finance, the Bank and Barclays Bank of Canada were amalgamated and continued under the name of Hongkong Bank of Canada effective August 31, 1996. These acquisitions were accounted for by the purchase method. The fair value of net assets acquired consists of:

Assets	*$ 483*
Liabilities	*449*
Net Assets acquired	*34*
Goodwill	*13*
Consideration paid in cash	*$ 47*

As consideration for the acquisition of the net assets of Barclays Bank of Canada, the Bank issued special shares for an aggregate consideration of $32.6 million. The special shares were subsequently redeemed on amalgamation for cash.

23. RELATED PARTY TRANSACTIONS:

The Bank pays guarantee fees to its direct Parent and an affiliate with respect to guarantees of certain debentures and deposit liabilities. The total fees for the year amounted to $34 million (1996 - $30 million).

See also note 10 relating to debentures.

During the year, the Bank entered into an agreement with an affiliate to provide a standby borrowing facility of up to US$200 million to the Bank at market rates and conditions. At no time during the year were funds drawn from the facility.

In addition to the above related party transactions, the Bank has transactions of a routine nature with its Parent and other affiliated companies, none of which is material to these financial statements.

On December 16, 1996 the Bank acquired, from an affiliate, two branches operating in the Pacific Northwest region of the United States. The Bank paid a cash consideration of $0.2 million being the book value of the net assets at the date of acquisition. Total assets at the date of acquisition were US$152 million.

The Bank's principal subsidiaries are as follows:

	Head Office	Book Value of Voting shares
HongkongBank Mortgage Corporation	*Vancouver, B.C.*	*$ 156*
Hongkong Bank Trust Company	*Edmonton, Alberta*	*35*
Canadian Direct Insurance Incorporated	*New Westminster, B.C.*	*25*
HSBC James Capel Canada Inc.	*Toronto, Ontario*	*4*
HSBC Capital Canada Inc.	*Vancouver, B.C.*	*3*
Hongkong Bank Discount Trading Inc.	*Toronto, Ontario*	*1*
Hongkong Bank Securities Inc.	*Vancouver, B.C.*	*1*
M.K. Wong & Associates Ltd.	*Vancouver, B.C.*	*14*

The Hongkong Bank of Canada holds 100% voting shares in all subsidiaries identified above.

24. RISK MANAGEMENT POLICIES:

a) Overall Approach

The Bank has adopted a prudent approach to risk management by implementing policies which encourage development of profitable business strategies within acceptable well defined risk limits which are monitored on a regular basis.

It is the responsibility of management to develop policies and procedures to monitor and control the business risks in the environment that the Bank operates. The Bank, as part of the HSBC Holdings plc international group of financial institutions, utilizes the basic risk management processes adopted by the Group. However, these are tailored to the Canadian banking environment.

The process and overall limits recommended by management are reviewed and the limits are approved by the Board of Directors on an annual basis. The Bank's internal audit department assesses each area of the Bank's operations and carries out appropriate assurance procedures to monitor the risk management process and ensure that it has not been compromised.

The Bank also controls its risk by ensuring that appropriate reporting systems and processes exist to monitor its risk areas and the Bank employs appropriately qualified staff to manage and monitor the risk process.

b) Major Types of Risk

The major types of risk inherent in the banking environment include credit, liquidity, interest rate and foreign exchange rate risks. Other risks which are actively managed include market and operational risk.

Credit risk is the risk that the Bank will incur a loss because its counterparty to a transaction fails to meet its obligations to the Bank. Transactions which involve credit risk include loans or other commitments including derivative contracts where the Bank, by extending credit, risks loss.

Liquidity risk is the risk that the Bank will encounter difficulty in raising funds to meet commitments.

Market, interest rate and foreign exchange rate risks are the risks that the value of the Bank's assets will fluctuate due to changes in market values of securities or to changes in interest and foreign exchange rates.

Operational risk is the risk of loss should the Bank encounter errors or failures to correctly process transactions or information.

c) Risk Management Practices

In controlling its risks, the Bank has adopted a number of risk management practices and controls to ensure all transactions and processes involving risk are identified and subject to appropriate authorized control procedures so as to minimize the potential for loss. Risk management practices are summarized as:

– written policies approved by the Board;

– position and control limits where appropriate to limit exposures; approved by the Board;

– committees of management and the board review positions taken and approve proposed transactions;

– regular monitoring of all types of information pertaining to risk, particularly exception reporting of overlimit transactions or unmatched/unhedged items;

– training of all Bank staff to ensure sufficient understanding of risk situations so as to reduce the amount of risk exposure; and

– independent internal audit function which is focused on areas of most significant risk.

Management

HEAD OFFICE

885 West Georgia Street
Vancouver, B.C. V6C 3E9
Tel: (604) 685-1000
Fax: (604) 641-1849
Web site: http://www.hkbc.com

TORONTO EXECUTIVE OFFICES

70 York Street
Toronto, Ontario M5J 1S9
Tel: (416) 868-8000
Fax: (416) 868-3819

W.R.P. DALTON
President and Chief Executive Officer

Y.A. NASR
Deputy Chief Executive Officer

M.J.G. GLYNN
Chief Operating Officer

J.L. GORDON*
Senior Executive Vice-President

B.A. GIACOMAZZI
Chief Credit Officer

J.T. MOULD
Chief Financial Officer and Ombudsperson

S.R. BABANI
Senior Vice-President, Human Resources

J.F. MAHAFFY*
Senior Vice-President, Financial Services

J.B. MEREDITH*
Senior Vice-President, Treasury

R. MORGAN
Senior Vice-President, Services

S.P. O'SULLIVAN
Senior Vice-President, Distribution Systems

A.H. TONG
Senior Vice-President, Group Systems Development Centre

R.S. ANTHONY
Vice-President, Credit West

L.S. BAILEY
Vice-President, Distribution Systems

P.H.C. BLONDEL*
Vice-President, International Trade

D.E. BOND
Vice-President, Government and Public Affairs and Chief Economist

J. BOOK*
Vice-President, Investment Services

J.B. HOWDEN*
Vice-President, Risk Management and Credit Services

H. KOA
Vice-President, Financial Services Systems

R.M. LEURY
Vice-President, Banking Systems

J.G.S. McCULLOCH
Vice-President, Marketing

W. McLANEY*
Vice-President, Credit East

K.C. MATHESON
Vice-President, Strategic Development and Financial Management

M. MILLER
Vice-President, Legal Counsel and Corporate Secretary

R.J. ROSS*
Vice-President, Corporate Banking

D.M. SARGEANT
Vice-President and Chief Auditor

M.J. STEVULAK
Vice-President, Hongkong Bank Leasing

A.C.H. YIP**
Vice-President and Representative, Hongkong Bank of Canada Representative Office

C.J. YOUNG
Vice-President and Chief Accountant

* Toronto
** Hong Kong S.A.R.

B.C. REGION

J.C. DOWLE
Senior Vice-President,
Vancouver Main Branch
885 West Georgia Street
Vancouver, B.C. V6C 3G1

I.D. HARPER
Senior Vice-President, B.C. Region
885 West Georgia Street
Vancouver, B.C. V6C 3E9

D.S. LEE
Senior Vice-President,
B.C. Region and Manager
Wayfoong House Branch
608 Main Street
Vancouver, B.C. V6A 2V3

S.A. MORGAN-SILVESTER
Senior Vice-President, B.C. Region and Marketing
885 West Georgia Street
Vancouver, B.C. V6C 3E9

M.P. CEPIN
Vice-President, Commercial Banking
Vancouver Main Branch
885 West Georgia Street
Vancouver, B.C. V6C 3G1

W.C. CRAWFORD
Vice-President, Personal Banking
Vancouver Main Branch
885 West Georgia Street
Vancouver, B.C. V6C 3G1

H. FETIGAN
Vice-President, Business Development, B.C. Region
Vancouver Main Branch
885 West Georgia Street
Vancouver, B.C. V6C 3G1

T.A. HOCKIN
Vice-President and Manager
North Vancouver Branch
1457 Lonsdale Avenue
North Vancouver, B.C. V7M 2H9

H.K.B. LUKE
Vice-President and Manager
Parker Place Branch
1010-4380 No. 3 Road
Richmond, B.C. V6X 3V7

R.S. RAMSHAW
Vice-President and Manager
Douglas and Hillside Branch
2640 Douglas Street
Victoria, B.C. V8T 4M1

J.S.C. SIT
Vice-President and Deputy Manager
Wayfoong House Branch
608 Main Street
Vancouver, B.C. V6A 2V3

G.J. SPRUNG
Vice-President, Commercial Banking
Vancouver Main Branch
885 West Georgia Street
Vancouver, B.C. V6C 3G1

G.C.W. YEU
Vice-President and Manager
Fortuna House Branch
6168 No. 3 Road
Richmond, B.C. V6Y 2B3

B.J. YOUNG
Vice-President, Commercial Banking
Vancouver Main Branch
885 West Georgia Street
Vancouver, B.C. V6C 3G1

WESTERN REGION

A.M. PAPADATOS
Senior Vice-President, Western Region
777 - 8th Avenue S.W.
Calgary, Alberta T2P 3R5

E.V. ANDRUSIAK
Vice-President and Manager
Jasper Avenue Branch
10561 Jasper Avenue
Edmonton, Alberta T5J 1Z4

T. LAWLER
Vice-President and Manager
8th Avenue Branch
777 - 8th Avenue S.W.
Calgary, Alberta T2P 3R5

ONTARIO REGION

J.C. LAM
Senior Vice-President, Ontario Region
70 York Street
Toronto, Ontario M5J 1S9

N.A. NICOLAOU
Senior Vice-President, Ontario Region
70 York Street
Toronto, Ontario M5J 1S9

E.A. DALGARNO
Vice-President, Business Development,
Ontario Region
70 York Street
Toronto, Ontario M5J 1S9

G. HOY
Vice-President and Manager
Toronto Main Branch
70 York Street
Toronto, Ontario M5J 1S9

D.K.H. POON
Vice-President and Manager
Willowdale Branch
3640 Victoria Park Avenue
Willowdale, Ontario M2H 3B2

J.P. YOUNG
Vice-President and Manager
Milliken Square Branch
15 Milliken Boulevard
Scarborough, Ontario M1V 1V3

QUÉBEC AND ATLANTIC REGION

M. DUFRESNE
Senior Vice-President, Quebec and
Atlantic Region
500 René-Lévesque Ouest
Montréal, Québec H2Z 1W7

L. LALIBERTÉ
Vice-President and Manager
2000 Mansfield Branch
2000 Mansfield Street
Montréal, Québec H3A 2Y8

PRINCIPAL OPERATING SUBSIDIARIES

G. CLOUTIER
President and Chief Executive Officer
Canadian Direct Insurance Incorporated
217 - 610 6th Street
New Westminster, B.C. V3L 3C2

G.A. McISAAC
Chief Operating Officer and
Chief Financial Officer
Canadian Direct Insurance Incorporated
217 - 610 6th Street
New Westminster, B.C. V3L 3C2

P.J. HICKMAN
President and Chief Executive Officer
Hongkong Bank Discount Trading Inc.
16th Floor
70 York Street
Toronto, Ontario M5J 1S9

S.J. WILSON
President
Hongkong Bank Securities Inc.
2520 - 1066 West Hastings Street
Vancouver, B.C. V6E 3X1

J.R. BLACKMER
Vice-President, Private Client Services
Hongkong Bank Trust Company
6th Floor
885 West Georgia Street
Vancouver, B.C. V6C 3E9

D.F. MULLEN
Chief Executive Officer
HSBC Capital Canada Inc.
11th Floor
885 West Georgia Street
Vancouver, B.C. V6C 3E8

R.W. NESBITT
President and Chief Executive Officer
HSBC James Capel Canada Inc.
Suite 1200
105 Adelaide Street West
Toronto, Ontario M5H 1P9

M.A. WEISDORF
Executive Vice-President and Managing
Director, Investment Banking
HSBC James Capel Canada Inc.
Suite 1200
105 Adelaide Street West
Toronto, Ontario M5H 1P9

R. RENOUF
Vice-President, Corporate Finance
HSBC James Capel Canada Inc.
Suite 2200
777 - 8th Avenue S.W.
Calgary, Alberta T2P 3R5

M.K. WONG
President and Chief Executive Officer
M.K. Wong & Associates Ltd.
2520 - 1066 West Hastings Street
Vancouver, B.C. V6E 3X1

J.K. MIDGLEY
Chief Operating Officer
M.K. Wong & Associates Ltd.
2520 - 1066 West Hastings Street
Vancouver, B.C. V6E 3X1

Branches

BRITISH COLUMBIA

Abbotsford
Burnaby (3)
Campbell River
Chilliwack
Cranbrook
Delta
Kamloops
Kelowna (2)
Langley
Maple Ridge
Nanaimo (2)
New Westminster (2)
North Vancouver (2)
Penticton
Port Coquitlam
Prince George
Richmond (5)
Surrey
Vancouver (17)
Vernon
Victoria (4)
West Vancouver
White Rock

ALBERTA

Calgary (5)
Edmonton (4)
Lethbridge
Medicine Hat
Red Deer

SASKATCHEWAN

Regina
Saskatoon

MANITOBA

Winnipeg

ONTARIO

Barrie
Brampton
Etobicoke
Hamilton
Kingston
Kitchener
London
Markham (2)
Mississauga (5)
Oakville
Ottawa
Richmond Hill
St. Catharines
Sault Ste. Marie
Scarborough (3)
Thunder Bay
Timmins
Toronto (4)
Unionville
Vaughan
Whitby
Willowdale
Windsor

QUÉBEC

Brossard
Chicoutimi
Laval
Longueuil
Montréal (3)
Québec City
Pointe Claire
Saint Léonard
Sherbrooke
Trois-Rivières

NEW BRUNSWICK

Fredericton
Saint John

NOVA SCOTIA

Dartmouth
Halifax

NEWFOUNDLAND

St. John's

UNITED STATES

Portland
Seattle

Board of Directors

J.R.H. BOND
Appointed Director June 18, 1987.
Resigned January 1, 1998. Group Chief Executive, HSBC Holdings plc. Group Chairman-Designate, HSBC Holdings plc.

J.L. BOUTET, C.M.
Appointed Director December 10, 1991.
President, C.B. Commercial Québec Inc.

I.M. BURNETT
Appointed Director January 1, 1998.
President and Chief Executive Officer, Marine Midland Bank and Chief Executive Officer, HSBC Americas Inc. effective January 1, 1998.

J.H. CLEAVE
Appointed Director June 18, 1987.
President and Chief Executive Officer, Marine Midland Bank and Chief Executive Officer, HSBC Americas Inc. until his retirement effective December 31, 1997.

W.R.P. DALTON
Appointed Director June 18, 1987.
Resigned January 1, 1998. President and Chief Executive Officer, Hongkong Bank of Canada until January 1, 1998. Chief Executive-Designate, Midland Bank plc.

P.Y.L. ENG
Appointed Director December 19, 1995.
Chairman, Allied Holdings Group.

W.A. FARLINGER, C.M.
Appointed Director February 1, 1994.
Chairman, President and Chief Executive Officer, Ontario Hydro.

T.C. HO
Appointed Director September 30, 1993.
Formerly Vice-Chairman and Chief Executive Officer, Hang Seng Bank Limited.

D.C. LOWE
Appointed Director May 23, 1997.
Chairman, Sedgwick Limited.

R.W. MARTIN
Appointed Director May 23, 1997.
Chairman, Silcorp Ltd.

G. MORGAN
Appointed Director December 12, 1996.
President and Chief Executive Officer, Alberta Energy Company Ltd.

Y.A. NASR
Appointed Director December 9, 1997.
President and Chief Executive Officer, Hongkong Bank of Canada effective January 1, 1998.

M.E. NESMITH
Appointed Director August 14, 1981.
Formerly President and Chief Executive Officer, and Vice-Chairman, Hongkong Bank of Canada. Founding President.

P. WALTON
Appointed Director January 19, 1987.
President and Director, Walton Management Inc.

K.R. WHITSON
Appointed Director January 1, 1998.
Chief Executive, Midland Bank plc.
Group Chief Executive-Designate, HSBC Holdings plc.

Hongkong Bank of Canada

Member HSBC *Group*

885 West Georgia Street, Vancouver, B.C. Canada V6C 3E9